IN THE

Supreme Court of the United States

OCTOBER TERM, 1944

No. .....

WESTERN MESA OIL CORPORATION and EL SEGUNDO OIL COMPANY,

Petitioners,

vs.

EDLOU COMPANY, *et al.*, Landowners in El Segundo Community Lease No. Four-A; EDLOU COMPANY, *et al.*, Landowners in El Segundo Community Lease No. Two-B; A. A. MCCRAY, Trustee for holders of overriding royalties in El Segundo Community Lease No. Four-A; A. A. MCCRAY, Trustee for holders of overriding royalties in El Segundo Community Lease No. Two-B; A. A. MCCRAY, WM. H. RAMSAUR and F. R. C. FENTON,

Respondents.

BRIEF IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI.

Opinion Below.
Jurisdiction.
Question Involved.
Statement of Case.

The essential facts relative to the foregoing matters are stated in the accompanying petition for Writ of Certiorari, and in the interests of brevity are not repeated herein.

Specification of Errors.

The Circuit Court of Appeals erred:

(1) In holding that the plan of arrangement could provide for the payment in full for one class of unsecured creditors, and the payment of 20 cents on the dollar to other classes of unsecured creditors, there being no legal reason or ground for such discrimination.

(2) In interpreting a plan of arrangement as calling for a discriminatory treatment between classes of creditors, the said arrangement being capable of interpretation avoiding such discrimination and unfairness.

(3) In holding that the debtor under a plan of arrangement can bar the right of the receiver and other creditors to object to the unfair and inequitable preference of one class of unsecured creditors over another.

Argument and Authorities in Support of Petition for Writ of Certiorari.

The debtor's revised plan of arrangement provided:

> "Landowners' royalties which carry with them the right of forfeiture of the oil and gas leases under which such royalties are payable and where such right of forfeiture has not, prior to the filing of the petition in bankruptcy, been waived either in writing or by the conduct of the parties, will be paid in full in the same manner as priority claims. Where, however, the facts disclose that prior to the filing of the proceedings hereunder by the debtor, the landowners, by writing or by their conduct, have legally waived the right of forfeiture as to any of the unpaid royalties, the same will be treated the same as those in the class of unsecured creditors. Should any contro-

> versy arise as to the proper status of such claims of holders of landowners' royalties, the same shall be determined by the above entitled Court in the above entitled proceeding upon hearing after notice." [R. 81.]

It is necessary to understand that the law of the State of California offers a landowner no lien or other priority for a claim of rent or royalty. It was conceded in the proceedings below that respondents, under the law, occupied no position superior to that of other unsecured creditors in the bankruptcy estate. It was only in the event that respondents had exercised the right of forfeiture in the oil leases whereunder their claims accrued, that respondents could have enjoyed a position of superiority over the other unsecured creditors of the estate. Had they exercised their right of forfeiture, then they might have been in a position to demand payment in full as a condition to the reinstatement of the leases. It was for this reason, then, that the debtor in proposing a plan of arrangement provided for the payment in full of the claims of royalty holders "which carry with them the right of forfeiture." There was no extraneous evidence to aid the lower court in interpreting the provision of the plan of arrangement with respect to the payment of the claims of the holders of landowners' royalties. The only logical interpretation of the language used in the plan of arrangement was that contended for by the petitioners, to-wit, that payment in full be limited to those landowners whose claims carried the right of forfeiture or, in other words, who had exercised the right of forfeiture by the giving of such notices as were required under the leases. It was

conceded below that the right of forfeiture had not been exercised by the respondents [R. 254]. Despite the fact that this is the only reasonable construction of the language used, there being no reason or right whereby the debtor could prefer the landowners if they had not exercised or perfected their right of forfeiture, the Bankruptcy Court, affirmed by the Circuit Court below, adopted a construction of the provision entirely at odds with the intent and purposes of the plan of arrangement. The Circuit Court of Appeals construed the language to refer to the claims of landowners whose leases included provisions for forfeiture in the event of non-payment of royalties. The mere existence of the forfeiture clause would not serve to enlarge the rights of respondents. The exercise of the right of forfeiture might have such effect. This Court may not be concerned with the error of the lower courts in construing language in a manner unsupported by the evidence. This Court is concerned, however, with the fact that in its erroneous conclusion the Honorable Circuit Court of Appeals modified a plan of arrangement which was otherwise "fair and equitable" into a plan that was neither fair nor equitable, and in direct violation of the provisions of the Bankruptcy Act relating to plans of arrangement. In doing this. the Circuit Court of Appeals held that a plan of arrangement may provide for the division of creditors into separate classes, and for the treatment of such classes on different terms and in different ways. The Circuit Court said: "Appellants' contention that such an arrangement is invalid because giving a priority to one class of unsecured claims over another is without merit." [R. 253.] The Circuit Court relied upon certain sections of the Bankruptcy Act of

1938, to-wit: Sections 306, 351, 356 and 357 of said Act. (11 U. S. C. A. 706, 751, 756 and 757.) This decision which fails to take into regard the limitation of Section 366(3) of the Bankruptcy Act of 1938, results in a dangerous departure from the inherent equitable principles underlying bankruptcy law, and gives approval to plans of arrangement which are essentially discriminatory and inequitable. The Circuit Court failed to give effect to the entire Bankruptcy Act, particularly all of Chapter XI relating to arrangements. Had it given effect to all of Chapter XI, the Circuit Court would have been compelled to limit Section 357 of the Bankruptcy Act by Section 366(3) of said Act, which makes it mandatory that a plan of arrangement be "fair and equitable." The law does not permit discriminations. The Bankruptcy Act permits the treatment of separate classes of creditors in different ways and upon different terms, provided that classes of equal standing are treated in parity with each other, and provided further that the result thereof is fair and equitable.

The Circuit Court below ignored the historical development of Chapter XI of the Bankruptcy Act relating to arrangements. Section 357(1) which provides for the division of creditors into classes and the treatment of such classes in different ways and upon different terms was not intended to be an isolated blanket authority, divorced from the remaining restrictions and provisions in Chapter XI. The sponsors of Section 357(1) commented that such section was subject to "the inherent restriction that the classification must be upon a reasonable basis and the express provision that the court must approve the plan as

fair and equitable." *Analysis of H. R. 12889, 74th Cong., 2d Sess. (1936) 42.* (H. R. 12889 is the forerunner of the Bankruptcy Act.)

The requirement of Section 366(3) that the plan be fair and equitable essentially contemplates that there be no unfair discrimination between classes of creditors. This is evident from the *Analysis of H. R. 12889, 74th Cong., 2d Sess. (1936),* p. 78, with respect to the meaning of "fair and equitable" as applied to plans of reorganization. It is there stated:

> "Derived from 77 B f (1). 'Equitable' would include 'fair,' and would also prevent an unfair discrimination in favor of any class of creditors or stockholders. The provision has been condensed accordingly."

It is obvious, then, that Congress felt that it would merely have been redundant to have expressly stated that a plan of arrangement must avoid unfair discriminations in favor of any class of creditors. The words "fair and equitable" have been held to be "words of art" with well understood meaning. (*Securities & Exchange Commn. v. U. S. Realty & Improvement Co.* (1940), 310 U. S. 434, 60 Sup. Ct. 1044, 84 L. Ed. 1293.) (See particularly the dissenting opinion of Justice Roberts.)

The decision of the Circuit Court of Appeals is in direct conflict with that of the Honorable Circuit Court of Appeals for the Second Circuit in the case of *Lane v. Haytian Corporation of America,* 117 Fed. (2d) 216, 220, which expressly declares that a preference given to one class of creditors over another "violates the principle of parity of treatment required by Section 366(3) * * *."

The decision of the Circuit Court below is also in conflict with that of the Honorable Circuit Court of Appeals for the Seventh Circuit in the case of *In Re Palisades-on-the-Desplaines,* 89 Fed. (2d) 214 (decided under former Section 77-B). The decision of the Circuit Court below is in conflict with the principles enunciated by this Honorable Court in the case of *American United Mutual Life Insurance Co. v. City of Avon Park* (1940), 311 U. S. 138, 61 S. Ct. 157, 85 L. Ed. 91, in which this Court said:

> " 'Beyond that is the question of unfair discrimination to which we have adverted. Compositions under chap. IX, like compositions under the old Sec. 12, envisage equality of treatment of creditors. Under that section and its antecedents, a composition would not be confirmed where one creditor was obtaining some special favor or inducement not accorded the others, whether that consideration moved from the debtor or from another. Re Sawyer (DC) 2 Low. Dec. 475, Fed. Cas. No. 12,395; Re Weintrob (DC) 240 F. 532, 39 Am. Bnkr. Rep. 407; Re M. & H. Gordon (DC) 245 F. 905, 40 Am. Bankr. Rep. 301. As stated by Judge Lowell in Re Sawyer, *supra,* "If a vote is influenced by the expectation of advantage, though without any positive promise, it cannot be considered an honest and unbiased vote." That rule of compositions is but part of the general rule of "equality between creditors" (Clarke v. Rogers, 228 U. S. 534, 548, 57 L. ed. 953, 959 S. Ct. 587, 30 Am. Bankr. Rep. 39) applicable in all bankruptcy proceedings. That principle has been imbedded by Congress in chap. IX by the express provision against unfair discrimination.' "

By giving effect to Section 357(1) of the Bankruptcy Act without regard to its qualification by Section 366(3) of the Bankruptcy Act, the Circuit Court below ignored elementary principles in the construction of statutes, that every section, provision and clause shall be expounded by a reference to every other; that every clause and provision shall have the effect contemplated by the legislature; that one portion should not be construed to annul or destroy what has been clearly granted in another; and that all sections, paragraphs and clauses, if possible, shall be so construed that all may stand together.

Peck v. Jenness, 7 How., 48 U. S. 612, 12 L. Ed. 841;

Colby v. Ledden, 7 How., 48 U. S. 626, 12 L. Ed. 847;

Ginsberg v. Popkin, 285 U. S. 204, 76 L. Ed. 704, 52 S. Ct. 322.

The decision of the court below infers that the creditors participating under the plan of arrangement were bound to a construction of the plan of arrangement as interpreted by the court below resulting from a purported ambiguity created by the debtor. Were there such an estoppel, it would not serve to have estopped the creditors of this estate represented by the receiver and the new corporation (whose stockholders consisted of the unsecured creditors) from asserting the unfairness and inequity of the revised plan of arrangement as construed by the court

below. The receiver and the new company, in behalf of the creditors thus discriminated against, opposed the discrimination. It would appear also that the court *sua sponte* would have acted to avert the discriminatory effect of the payment of 100¢ on the dollar to one class of creditors who enjoy no greater legal rights than those of other classes of creditors who were paid only 20¢ on the dollar in the form of stock of a new corporation. Appellant Western Mesa Oil Corporation is the corporation which immediately took over the assets of the debtor company for the purpose of facilitating the transfer to the new corporation, and appellant El Segundo Oil Company is the new corporation whose stock was issued to unsecured creditors and who took over the assets from Western Mesa Oil Corporation. Appellants, therefore, are the unsecured creditors who were discriminated against by this plan of arrangement.

It should be apparent that the decision of the Circuit Court of Appeals below is such that, if permitted to stand, it will create inestimable confusion and havoc in the administration of Chapter XI proceedings. It is of utmost importance that this court take jurisdiction by certiorari and resolve the conflict of opinion existing between the decision of the Circuit Court of Appeals for the Ninth Circuit and the other Circuits. Chapter XI, a part of the Chandler Act of 1938, is still in its early stages of operation. There is still much confusion with respect to its provisions. The decision of the Ninth Circuit in this case

adds immeasurably to that confusion. The holding that a plan of arrangement may treat equal classes on different terms and discriminatorily is a dangerous precedent, and one which may be the instrument of great injustice. We respectfully urge that this petition should be granted.

Respectfully submitted,

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